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No. 10,198

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CONSOLIDATED CHOLLAR GOULD & SAVAGE MINING COMPANY (a corporation),
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Review of Decision of the United States Board of Tax Appeals.

BRIEF FOR PETITIONER.

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OPINION BELOW.

The opinion of the United States Board of Tax Appeals (R. 72-79) is reported in 46 B.T.A.—No. 34.

JURISDICTION.

The petition for review in this case involves asserted deficiencies in income taxes for the years 1936 and 1938 and is taken from decisions of the Board of Tax Appeals entered March 25, 1942. (R. 80-81.) The petition for review was filed June 24, 1942 (R. 82-87), pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

QUESTIONS PRESENTED.

Whether the petitioner is entitled to deduct, under Section 23 (m) of the Revenue Act of 1934 and the same section of the Revenue Act of 1936, percentage depletion in respect to income derived during the tax years 1936 and 1938 from the extraction of gold by the petitioner from certain dumps consisting of rocks and ore material which had never been milled or processed in any way but which had been deposited upon lands owned by the petitioner many years prior to the acquisition of said lands by the petitioner.

STATUTES AND REGULATIONS INVOLVED.

Revenue Act of 1934, c. 277, 48 Stat. 680:

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * (U.S.C., Title 26, Sec. 23.)

Sec. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * * * *

(b) *Basis for depletion.*

* * * * * * *

(4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. * * * (U.S.C., Title 26, Sec. 114.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

Art. 23 (m)-1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—* * *

* * * * * * *

(b) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral

extraction. The value of a mineral property is the combined value of its component parts.

* * * * * * *

(g) "Gross income from the property" as used in section 114 (b) (3) and (4) and articles 23 (m)-1 to 23 (m)-28, inclusive, means the amount for which the taxpayer sells (a) the crude mineral product of the property or (b) the product derived therefrom, not to exceed in the case of (a) the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before transportation from the immediate vicinity of the mine or well, or in the case of (b) the representative market or field price (as of the date of sale) of a product of the kind and grade from which the product sold was derived, before the application of any processes (to which the crude mineral product may have been subjected after emerging from the mine or well) with the exception of those listed below, and before transportation from the place where the last of the processes listed below was applied. * * *

* * * * * * *

(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

STATEMENT.

The petitioner is a corporation organized under the laws of the State of California with its principal office at San Francisco, California. It filed its income tax returns for the calendar years 1936 and 1938 with the Collector of Internal Revenue for the First District of California. On its income tax returns, the petitioner elected to have its depletion allowance computed on the basis of a percentage depletion. During the year 1936 the petitioner derived income in the amount of $71,211.40 from the processing of certain dumps known as the Yellow Jacket and Belcher Dumps, located on property known as the American Flat property near Virginia City, Nevada. During the year 1938, the petitioner realized income from the processing of ores in these dumps in the amount of $2924.12. (R. 73.) It was stipulated that petitioner's net income, before depletion, from this source for 1936 was $22,610.70, and that the net income, before depletion, from this source for the year 1938 was $2924.12. (R. 69-70.) The petitioner in computing its tax upon its returns claimed percentage depletion in accordance with its election with respect to said income. The respondent disallowed the percentage depletion claimed and gave notices of deficiencies in the tax for both years. The petitioner thereupon filed two separate petitions with the Board of Tax Appeals for redetermination of the asserted deficiencies. Both petitions were consolidated for hearing and decision before the Board of Tax Appeals. (R. 38.) The Board of Tax Appeals held, erroneously we believe, that the dumps in question

did not constitute a mine within the meaning of the statute (R. 75) and entered its decisions that there was a deficiency in the income tax for the calendar year 1936 in the amount of $3625.45 and for the calendar year 1938 in the amount of $512.57. This petition for review is taken from those decisions. The facts are identical with respect to each year except as to the amounts involved, which are not in dispute.

STATEMENT OF POINTS TO BE URGED.

The Board of Tax Appeals erred:

1. In failing to hold that the ores and precious metals were naturally deposited in the dumps in question and that the same constituted a part of the taxpayer's mine within the meaning of Section 114 (b) (4) of the Revenue Acts of 1936 and 1938.

2. In holding that percentage depletion under said section of said acts is not allowable with respect to income derived from processing said dumps.

3. In holding that there were deficiencies in the income tax returns of the taxpayer for the years 1936 and 1938 by reason of the disallowance of the percentage depletion claimed by the taxpayer for those years.

4. In that its opinion and decision are contrary to its findings of fact.

5. In that its opinion and decision are not supported by its findings of fact and are contrary to law.

THE FACTS.

The petitioner acquired the American Flat property near Virginia City, Nevada, by purchase from Bullion Gold & Silver Mining Company on or about July 1, 1933 and during the taxable years in question was the owner of the property in fee. (R. 7-8, 17, 20-21, 30, 55.) Prior to such purchase and between the years 1872-1898 the predecessors of Bullion Gold & Silver Mining Company had removed from mines adjacent to the property a quantity of natural deposit ore material and placed the same upon the American Flat property. (R. 40-41.) Such ore material was taken from mines known as the Yellow Jacket, Crown Point, Belcher and Kentuck Mines. (R. 48-49.) The operators of these mines had made an arrangement with the Overman Mining Company, which was then the owner of the American Flat property, for the privilege of dumping such ore materials upon the American Flat properties. (R. 50.) The records concerning such arrangement were destroyed in the fire of 1906, but one of the operators of one of the mines testified that in 1907, the operators of the mines did not consider that they owned the dumps on the American Flat property. He testified that they considered that the Overman Mining Company, the owner of such property, was the owner of the dumps and the operators were "trying to make a dicker with the Overman Mining Company" for the privilege of working the dumps. (R. 50-51.) The dumps were not produced by the Overman mine. "They were just there." (R. 52.)

At the time the petitioner acquired the American Flat property, the dumps were from 60 to 80 feet high. (R. 66.) Their physical appearance after the petitioner had removed a portion of the rock by power shovel for processing is shown by the photograph marked Petitioner's Exhibit 1, the original of which has been transmitted to this Court for inspection. The dumps are indicated by the white spot about two inches from the righthand side of the picture and in about the center vertically. (R. 58.)

The material constituting the dumps was waste rock blasted from the mines and deposited upon the American Flat properties just as it was blasted. (R. 42.) It had never been milled or processed and no effort had been made to segregate it or remove any of the ore materials from the rock. (R. 41-42, 55.) "Processing" is the process whereby metal is extracted from the rock. The first step in processing is milling. (R. 42.) Milling consists of crushing the rock into an impalpable powder after which the powder is processed by whatever system of processing may be used. (R. 45.) "Tailings" are the products of the mill resulting after the rock has been milled and the powder has been processed. (R. 45.) The material constituting the dumps in question was not tailings in any sense of the word (R. 45) but was blasted rock in which the metal was still naturally deposited at the time of the acquisition by the petitioner of the property on which the dumps were located. (R. 65.)

SUMMARY OF ARGUMENT.

The Board of Tax Appeals disallowed percentage depletion claimed by the petitioner and found that there were deficiencies due for the taxable years in question by reason of its holding that the dumps did not constitute a mine within the meaning of the statute. While five specifications of error and points to be urged are set forth, if the Board was in error in failing to hold that the dumps constituted a mine and the minerals therein a natural deposit within the meaning of the statute, it will follow that the other points urged will be disposed of. The petitioner therefore confines its argument in this brief to the contention that the dumps and minerals therein constituted a mine or other natural deposit within the meaning of the statute.

ARGUMENT.

THE DUMPS CONSTITUTED A MINE WITHIN THE MEANING OF THE STATUTE.

The decision of the Board of Tax Appeals is predicated primarily upon the holding of the Board that the dumps in question did not constitute a mine within the meaning of the statute. (R. 75.) If this is considered a finding of fact, it is not such a finding of fact as must be deemed conclusive upon review. All of the evidence before the Board, including all of the testimony of the witnesses, is set forth in the record before this Court. There was no conflict in the evidence and it was uncontradicted. The review-

ing Court is not bound by facts determined by the lower Court based upon uncontradicted evidence.

5 *Corpus Juris Sec.* p. 558.

The question of what constitutes a "mine" within the meaning of a particular statute is a question of law for the Courts to determine.

In the well considered case of

Nephi Plaster & Mfg. Co. v. Juab County, 33 Utah 114, 118, 93 Pac. 53, 14 L.R.A. (N.S.) 1043,

the Supreme Court of Utah said:

> "The question, however, is what is to be deemed as being within the popular conception of a mine? Is it to be confined to the understanding that a farmer, stock raiser, or ordinary merchant has of the term? Or to what those who work in or come in contact with mines and mining rights generally and popularly understand it to be? Or is it to be understood, when found in a statute or Constitution, what the courts generally have held it to mean? In view that the decisions of courts are but the reflection of the common understanding with respect to particular things and the terms used in any industry, business, or calling, and are thus simply reduced to legal terms, we think that if the courts have construed and applied what is meant by the terms 'mine' and 'mines', then this meaning must control, and especially so when the term is used in some statute or constitution. This must be so for the simple reason that the term will then have acquired a legal meaning, which, unless the contrary clearly appears from the context, must be deemed to be the meaning intended to be applied to it in the law in which it is found."

There have been a number of federal cases in which the nature of a "tailings dump" has been considered in relation to Section 23 (m) of the Revenue Act. One of the latest of such cases is

Commissioner of Internal Revenue v. Kennedy Mining & Milling Co., 125 Fed. (2d) 399,

decided by this Court February 4, 1942.

In the case of

Atlas Milling Co. v. Jones, 10th Circuit, 115 Fed. (2d) 61,

relied upon by the Commissioner and cited in the decision of the Board of Tax Appeals, the Court had held that percentage depletion was not allowable in respect to the reworking of tailings. The Court in the *Atlas* case defined a "mine" as follows:

> "A 'mine' is an excavation in the earth from which ores, coal, or other mineral substances are removed by digging or other mining methods. In its broader sense it denotes the vein, lode, or deposit of minerals. Mining connotes the removal of minerals from a natural deposit. It does not embrace the reworking of mineral dumps artificially deposited from the residue remaining after the ore has been milled and concentrates removed therefrom. So. Utah Mines & Smelters v. Beaver County, 262 U.S. 325, 332. In the case last cited the court said:
>
> " 'The tailings, severed and removed from the mining claims, changed in character, placed on other and separate lands and having an ascertained and adjudicated value of their own, in our opinion, constituted a unit of property entirely apart from the mine from which they had been taken. See Forbes v. Gracey, 94 U.S. 762, 765.' "

The *Kennedy* case before this Court involved the reworking of tailings by the mine owner. The Commissioner contended before this Court, on authority of the definition given in the *Atlas* case, that the reworking of the tailings could in no sense be regarded as a mining operation. This Court held otherwise and distinguished the *Atlas* case on the ground that in that case, the taxpayer was a contractor which had contracted with the owner of the tailings dump to treat the tailings therein for a share of the proceeds. Neither party owned any mine.

The present case differs from the *Atlas* case in that the petitioner in this case acquired the dumps as a part of its mining property and owned them in fee. The case differs from the *Kennedy* case in that the dumps were created with waste rock taken from adjacent mines, not owned by the petitioner, from thirty to sixty years before the petitioner acquired the lands on which the dumps were deposited. This case differs from both the *Atlas* and *Kennedy* cases in that the dumps are not tailings in any sense of the word, had never been milled or processed when acquired by petitioner, but consisted of rock, just as it was blasted in which the metal was still naturally deposited. It also differs from both cases in that the petitioner's predecessor in ownership of the land was considered to have become the owner of the dumps thereon, and the only economic interest in the dumps is that of the petitioner, which is ownership in fee.

In 50 *Corpus Juris,* pages 768-769, it is stated:

> "The character of property may, in some instances, be changed from personalty to realty,

> or from realty to personalty, by the act of the owner or other person in dealing with it. * * * It is held, however, that, to convert an article which is a part of the realty into a chattel by severance, the act must be done by one having the right or authority to do so, and with the intention of so converting it, and that what is realty continues to be so until the owner by his election gives it a different character. * * * 'Tailings' from ore reduction, deposited on adjoining property with the consent of the owner, may become part of realty; *and severed rock deposited upon another's land and permitted to remain becomes real property.*" (Italics ours.)

In the case of *Anderson v. Helvering,* 310 U.S. 404, 407, 60 Sup. Ct. 952, 954, one of the cases relied upon by the respondent before the Board, the Court in discussing the question of depletion allowance in the case of oil and gas wells, said:

> "It is settled that the same basic issue determines both to whom income derived from the production of oil and gas is taxable and to whom a deduction for depletion is allowable. *That issue is, who has a capital investment in the oil and gas in place and what is the extent of his interest.* * * *" (Italics ours.)

In the case of *Helvering v. Bank Line Oil Co.,* 303 U.S. 362, 366, 367, 58 Sup. Ct. 616, 618, another case cited by the respondent, the Court said:

> "In order to determine whether respondent is entitled to depletion with respect to the production in question, we must recur to the fundamental purpose of the statutory allowance. The

> deduction is permitted as an act of grace. It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production. United States v. Ludey, 274 U.S. 295, 302, 47 S. Ct. 608, 610, 71 L. Ed. 1054. The granting of an arbitrary deduction, in the case of oil and gas wells, of a percentage of gross income, was in the interest of convenience and in no way altered the fundamental theory of the allowance. United States v. Dakota-Montana Oil Co., 288 U.S. 459, 467, 53 S. Ct. 435, 438, 77 L. Ed. 893. The percentage is 'of the gross income from the property,'—a phrase which 'points only to the gross income from oil and gas.' Helvering v. Twin Bell Syndicate, 293 U.S. 312, 321, 55 S. Ct. 174, 178, 79 L. Ed. 383. *The allowance is to the recipients of this gross income by reason of their capital investment in the oil or gas in place.* Palmer v. Bender, 287 U.S. 551, 557, 53 S. Ct. 225, 226, 227, 77 L. Ed. 489." (Italics ours.)

The rock or ore material constituting the dumps was therefore a part of the realty purchased and owned by the petitioner and a part of its capital investment, of which the petitioner was, during the tax years in question, the sole owner.

There is nothing in the definition of a "mine" in the case of *Atlas Milling Company v. Jones,* supra, from which it can be said that the dumps were not a "mine" within the meaning of the statute. The extent of the holding of the *Atlas* case, so far as the definition is concerned, is that mining "does not embrace the reworking of mineral dumps artificially

deposited from the *residue remaining after the ore has been milled and concentrates removed therefrom".* (Italics ours.) The Court did say "a 'mine' is an excavation in the earth from which ores, coal, or other mineral substances are removed by digging or other mining methods". The Court was here defining a mine in relation to the residue remaining from processed ores and was not considering waste rock or ore material which had never been processed but which was a part of the realty on which it had been deposited and allowed to remain. The Court continued: "In its broader sense it denotes the vein, lode, or deposit of minerals." This statement was undoubtedly taken from 40 *Corpus Juris* page 734, which further elaborates upon the definition as follows:

> "In a broad or enlarged sense the term 'mine' denotes the 'vein,' 'lode,' or 'deposit' of mineral, and is also used to denote the place where, or the parcel of land on which, such mineral vein or deposit is found. *In this sense it is a certain part of the soil or of the earth's surface in which there are mineral deposits, and in which a person obtains not only a full right of ownership of the soil, but a right to remove the minerals therefrom and to dispose of them as he sees fit."* (Italics ours.)

To hold that the restricted definition of a mine should apply in this case would be to render meaningless the words "other natural deposits" in Section 23 (m) of the Revenue Act. Section (n) (2) of the same Act, before its amendment in 1932, provided with respect to *discovery* depletion that

> "In the case of *mines* discovered by the taxpayer * * * the basis for depletion shall be the fair market value of the property * * *." (Italics ours.)

In

Pacher Gravel Co., 21 B.T.A. 51,

and

Dunn & Baker, Inc. v. C. I. R., 30 B.T.A. 663,

the Board of Tax Appeals pointed out that the discovery section refers only to "mines", while Section 23 (m) refers to mines and "other natural deposits", and that the omission of these latter words from Section 23 (n) indicated an intention on the part of Congress that the word "mines" in the discovery section was used in its restricted or narrow sense. The Board held that a gravel pit and a stone quarry were not "mines" as the term is used in the discovery section, although the Board said in the *Dunn & Baker* case:

> "Undoubtedly, petitioner's deposit of stone is a natural deposit which Congress specifically directs shall be subject to depletion allowances, but which it carefully refrained from including in the discovery provisions of the statute."

If the reasoning of the Board was correct in those two cases, as we believe it was, then conversely, the inclusion of the words "other natural deposits" in Section 23 (m), the percentage depletion section, indicates an intention that the word "mines" is used in that section in its broad sense. This construction of the statute applied to the present case would not

be inconsistent with holdings of the Courts that a tailings deposit is not a mine, because a tailings deposit is obviously not a natural deposit. After the rock has been milled into the powder from which the tailings deposit is created, such metal as remains in the powder has been disturbed and is not naturally "in place". In the case of the dumps in question, the gold and silver content was just as much in place in the rocks as if those rocks had never been removed from underground. The ore was not free in a metallurgical sense. The very fact that milling and reduction to an impalpable mass was necessary negatives any theory to the contrary.

The dumps were a certain part of the earth's surface containing mineral deposits, naturally in place in the rocks. They had become a part of the realty purchased and owned by the petitioner. The petitioner had not only the right of ownership but the right to mine the dumps and remove the minerals and to dispose of them as it should see fit. It is respectfully submitted that its operations in doing so were mining operations, and that under the proper definition of the word "mines" used in connection with the words "other natural deposits", in Section 23 (m), the dumps were the petitioner's mines and the minerals therein were the petitioner's natural deposits within the meaning of that section. It is therefore respectfully submitted that the decision of the Board of Tax Appeals in failing to so hold was contrary to and not supported by its findings of fact, and was contrary to law. By reason thereof, it is

respectfully submitted that the Board erred in disallowing percentage depletion and in finding that there were any deficiencies for the taxable years in question.

Dated, San Francisco,
September 10, 1942.

Respectfully submitted,
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